



Critical Quarter Ahead

With the holy month of Ramadan coinciding in 2Q, fast food sales generally decline versus prior quarter. However, this year we believe the results will shed light on traction from optimized network, raw material costs and market share gains. Strong topline will confirm if Herfy's strategy is paying-off, setting the stage for solid 2H19. Although we project -3% Y/Y EPS drop to SAR 0.69, lower input costs and rent could positively surprise. Shares have gained +25% YTD as we maintain Buy and SAR 58 target price, representing 14.1x 2020E EV/EBITDA.

Revenues expected to improve on better performing store mix

We project 6 new restaurant additions during the quarter, taking the total to 378. Over the past two years, Herfy has been evaluating underperforming stores to improve overall network metrics. We expect to see some results from these measures, as quarterly sales per restaurant improves to SAR 682k. Total revenues are forecast at SAR 298 mln (+4% Y/Y). Worth watching will be Company's plans for international expansion, which could help sustain growth.

Margin to benefit from input costs

Gauging from management commentary from food producers, it appears that food price environment is still benign although poultry prices may have started to inch higher. We expect lower input costs to provide gross margin relief, in addition to favorable rent conditions. Conversely, employee costs (comprising 28% of CoS in 2018) gained +12% last year, and could continue to rise in 2019.

Finance expense could squeeze earnings

IFRS 16-related right-of-use assets has resulted in higher financing expense (SAR 9.9 mln vs SAR 3.4 mln in 1Q19). Consequently, net income is estimated at SAR 44 mln (-3% Y/Y).

Market share gain will be critical

In our view, the QSR market is adjusting from demographic shake-up from expat outflow where stand alone restaurants are being challenged to maintain profitability. This creates opportunity for established chains, such as Herfy, to increase presense in under-served neighborhoods. Market share gain could help sustain growth in domestic market.

Herfy (SAR mln)	2Q19E	2Q18	Y/Y Chg	1Q19	Q/Q Chg	Consensus
Revenues	298	287	4%	313	-5%	306
Gross profit	86	79	10%	94	-8%	
Gross margin	29%	27%		30%		
Operating profit	55	50	10%	59	-7%	
Operating margin	18%	17%		19%		
Net income	44	46	-3%	48	-7%	49
Net margin	15%	16%		15%		16%
EPS (SAR)	0.69	0.71	-3%	0.74	-7%	0.76

SAR 58

12-Month Target price

Buy

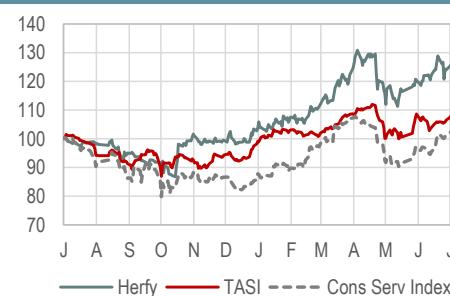
Recommendation

Stock Details		
Last Close Price	SAR	57.20
Upside to target	%	1.4
Market Capitalization	SAR mln	3,700
Shares Outstanding	mln	65
52-Week High	SAR	59.70
52-Week Low	SAR	38.00
Price Change (YTD)	%	25.4
3-Mth ADTV	thd	58
EBITDA 2019E	SAR mln	311
Reuters / Bloomberg	6002.SE	HERFY AB

SAR mln	2018	2019E	2020E
Revenues	1,227	1,286	1,338
Gross Margin	28%	28%	28%
EBIT	221	234	237
Net Income	204	221	225
EPS (SAR)	3.16	3.42	3.48

Price Multiples			
	2018	2019E	2020E
P / E	18.1x	16.7x	16.4x
EV / EBITDA	15.0x	14.2x	13.9x
P / S	3.0x	2.9x	2.8x
P / B	4.0x	3.6x	3.4x

1-Year Share Performance (rebased)



Source: Bloomberg, Tadawul, SFC

Asim Bukhtiar, cfa

abukhtiar@fransicapital.com.sa

+966 11 282 6844



Research and Advisory Department

Rating Framework

BUY

Shares of company under coverage in this report are expected to outperform relative to the sector or the broader market.

HOLD

Shares of company under coverage in this report are expected to perform inline with the sector or the broader market.

SELL

Shares of company under coverage in this report are expected to underperform relative to the sector or the broader market.

Saudi Fransi Capital

Call Center | 800 125 9999

www.sfc.sa

Commercial Registration | 1010231217

Research and Advisory

P.O. Box 23454

Riyadh 11426

Saudi Arabia

Head Office | Riyadh

research&advisory@fransicapital.com.sa



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Saudi Fransi Capital (Closed Joint Stock Company owned by Banque Saudi Fransi)

C.R. 1010231217

Paid Up Capital 500,000,000 SR – Capital Market Authority 11153-37

Head Office

8092 King Fahd Road | Riyadh 12313-3735 | Kingdom of Saudi Arabia

Mailing Address:

P.O Box 23454

Riyadh 11426

Tel: +966 11 282 6666 | Fax: +966 11 282 6667

800 124 3232 | www.sfc.sa